6/16/88 A6910-1

National Association of Purchasing Management

Report On Business®
June 6, 1988
Volume 6, Number 6

Growth of new orders improves

Inventories increase

Price advances continue

Analysis by the National Association of Purchasing Management Business Survey Committee; chair, Robert J. Bretz, C.P.M., director of materials management, Pitney Bowes, Inc.

The *Report on Business* is based on data compiled from replies to questions asked of purchasing managers in some 250 industrial companies. Membership of the Business Survey Committee is diversified geographically, based on value added by state, and by Standard Industrial Classification category, based on each industry's contribution to national income.

May Report

The economy continued to expand in May, say the nation's purchasing managers in their latest **Report on Business.** Although the rate of growth in production was somewhat slower than in April, growth in new orders was slightly faster. Vendor deliveries remained slow, but not to the extent of the past 11 months, reflecting the slower production growth rate. Employment declined slightly for the third consecutive month. Inventories grew in May after remaining flat in April and decreasing in the two previous months. Prices increased again after taking normal seasonal variations into consideration. The strong growth in new export orders continued, but at a slower rate than in April. Of those members exporting, 35% reported higher export orders compared to 40% in April, bringing the average for the first five months of 1988 to 37.5%.

The report was issued today by Robert J. Bretz, C.P.M., chairman of the National Association of Purchasing Management's Business Survey Committee and director of materials management at Pitney Bowes, Inc. Said Bretz: "The economy continues to expand at a moderate rate. New orders, fueled by robust growth in export orders, increased at a brisk pace and all but assure the first half of 1988 will end with a record of modest but healthy economic growth."

The **Purchasing Managers' Index** increased to 55.1%, up slightly from 54.9% in April. May is the 22nd consecutive month this leading indicator has exceeded 50%. The 55.1% registered in May equals the 55.1% average for the first five months of 1988 as well as the first four months. Past experience indicates that, if this average were to continue for the remainder of 1988, it would be consistent with real GNP growth of about 3.4%, unchanged from last month. A reading above 50 indicates that the economy is generally expanding; below 50, that the economy is generally declining. The index is based on analysis by the U.S. Department of Commerce. Except for this index, the information in this report is not seasonally adjusted.

Net Difference

In each category measured, this report shows a net difference, the difference between the number of responses in the positive direction (higher, better, faster) and the negative direction (lower, worse, slower). Analysis of the month-to-month difference compares the rate of change.

Employment

Employment declined slightly in May for the third consecutive month when taking normal seasonal variations into consideration. The net difference (+3) between those indicating higher employment (14%) and lower (11%) also was slightly less than in April (+5).

Employment	% Higher	% Same	% Lower	Net
May	14	75	11	+3
April	16	73	11	+5
March	16	73	11	+5

Buying Policy

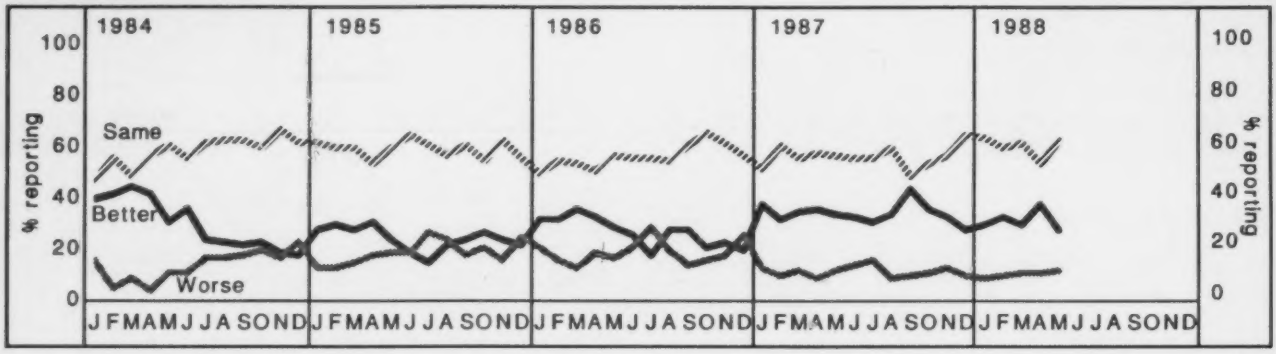
Lead times for production materials and maintenance, repair and operating (MRO) supplies continued to shorten, reflecting the easing in the rate at which vendor deliveries are slowing. Lead times of 60 days or less for production materials were reported by 78% of members, up from 75% in April and the most since September 1987 (80%). Lead times of 30 days or less for maintenance, repair and operating (MRO) supplies were reported by 87% of purchasers in May, up from 84% in April and 81% in March; this is the most since October 1987 (also 87%). However, lead times for capital expenditures lengthened somewhat, confirming the sharp increase in capital expenditures predicted by purchasers in their latest semiannual forecast on May 17. Lead times of 90 days or longer for capital purchases were reported by 74% of purchasers, up from 69% last month.

Percent Reporting

	Hand to Mouth	30 Days	60 Days	90 Days	6 Months and Longer
Production Materials					
May	15	41	22	14	8
April	15	39	21	19	6
March	14	33	24	23	6
MRO Supplies					
May	38	49	10	3	0
April	36	48	13	3	0
March	35	46	15	3	1
Capital Expenditures					
May	9	6	11	19	55
April	8	7	16	15	54
March	9	6	10	18	57

Report on Business is published by the National Association of Purchasing Management, Inc., 2055 East Centennial Circle, Post Office Box 22160, Tempe, Arizona 85282-0960. Telephone: 602/752-NAPM (752-6276). Telecopier: 602/752-7890. Distributed 12 times a year to N.A.P.M. members. Additional subscriptions are $50 a year for members, $100 for nonmembers. Add $25 outside the United States, Canada and Mexico.

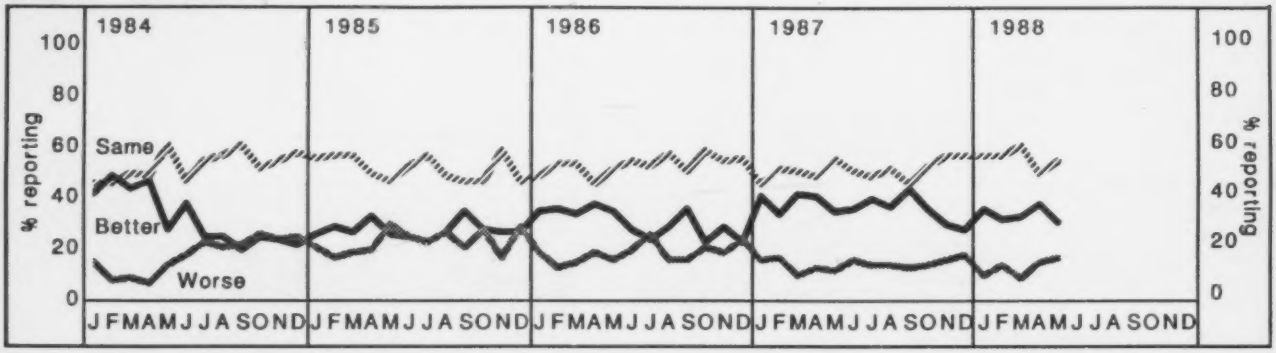
Production



May also marked the 17th consecutive month of growth in production. Although the number of members indicating better production fell to 27% from 37% in April, the actual slowing in the rate of growth was only slight when taking normal seasonal variations into consideration.

Production	% Better	% Same	% Worse	Net
May	27	62	11	+16
April	37	53	10	+27
March	29	61	10	+19

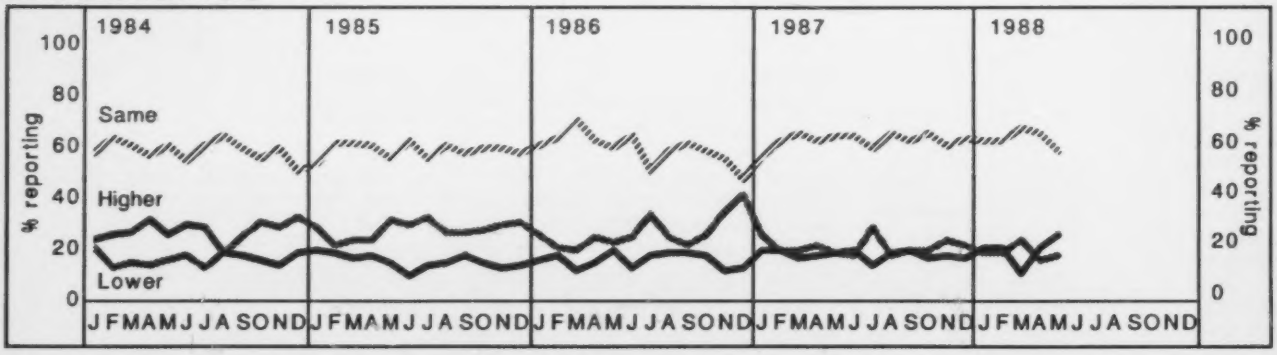
New Orders



New orders expanded for the 17th consecutive month. Although the net difference (+14) between the number of members reporting better new orders (30%) and worse (16%) decreased from +23, considering normal seasonal variations, the rate of growth actually increased slightly and augurs well for continued growth in production over the next 30 to 60 days.

New Orders	% Better	% Same	% Worse	Net
May	30	54	16	+14
April	37	49	14	+23
March	32	60	8	+24

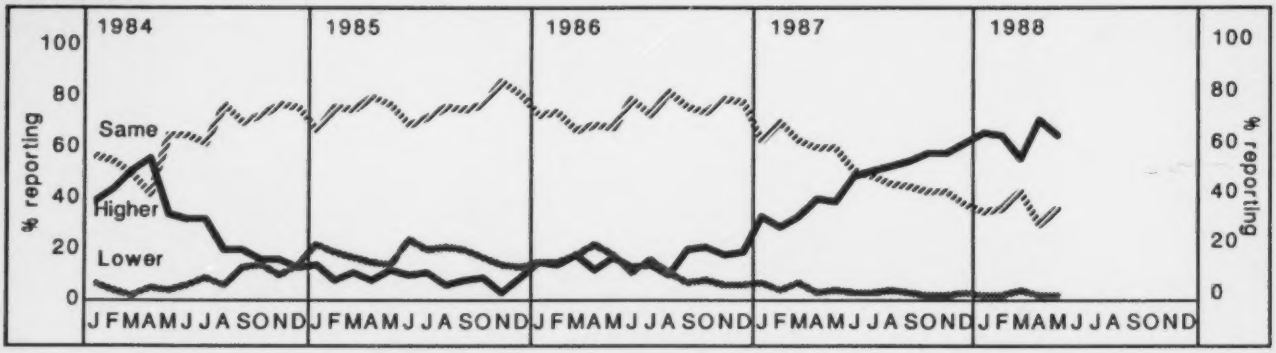
Inventories



Inventories expanded in May after no change in April and two previous months of decline. The 25% of members reporting higher inventories is the most since July 1984 (28%). However, some purchasers reported increasing their inventories in anticipation of suppliers' plant shutdowns for summer vacation and preventive maintenance as well as a hedge against protecting supplies of certain commodities in short supply.

Inventories	% Higher	% Same	% Lower	Net
May	25	58	17	+ 8
April	20	65	15	+ 5
March	10	67	23	−13

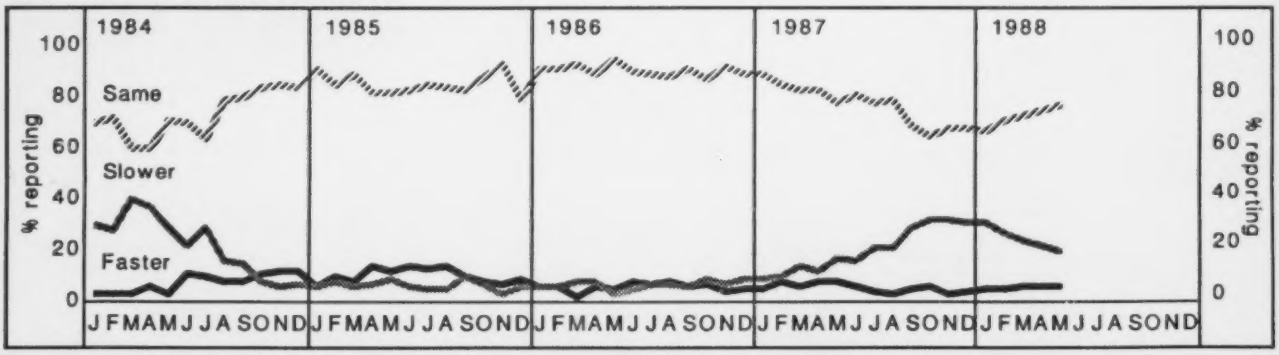
Prices


1984
1985
1986
1987
1988
100
80
60
40
20
0
% reporting
Same
Higher
Lower
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D

May marked the 20th consecutive month in which more purchasers reported higher prices than lower. The net difference (+63) between those reporting higher prices (64%) and lower (1%) is down sharply from April (+69). Nevertheless, considering normal seasonal variations, May could really be viewed as representing a slight rise in the rate of price increases.

Prices	% Higher	% Same	% Lower	Net
May	64	35	1	+63
April	70	29	1	+69
March	55	42	3	+52

Vendor Deliveries


1984
1985
1986
1987
1988
100
80
60
40
20
0
% reporting
Same
Slower
Faster
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D

For the 20th consecutive month, purchasers reported slower deliveries from their vendors. However, the rate at which vendor deliveries slowed was, once again, smaller. The net difference (−14) between those members reporting slower deliveries (19%) and faster (5%) is the smallest since June 1987 (−10).

Vendor Deliveries	% Faster	% Same	% Slower	Net
May	5	76	19	−14
April	5	74	21	−16
March	5	72	23	−18

Specific Commodity Changes

UP IN PRICE: Corrugated shipping containers (25th time in 26 months), folding cartons (third consecutive month), paper products and packaging (fourth consecutive month), wood pulp (used in making all grades of paper and linerboard), caustic soda (18th consecutive month; used heavily in paper-making, petroleum refining and soap-making), aluminum (16th consecutive month), copper (14th time in 15 months; some reports of price decreases), nickel (third consecutive month; used heavily in making stainless steel, plating metals and batteries), steel (20th time in 21 months), stainless steel (fifth consecutive month), steel products (seventh consecutive month), zinc (fourth time in five months; used heavily in metal alloys and as a protective coating for metals), polyethylene (11th time in 12 months; used heavily in making packaging materials and paper coatings), polypropylene (used in making thermoplastic plastics or fibers), plastic resins (11th time in 12 months), polystyrene (used chiefly in making synthetic rubber, plastic resins and plastic), plastic products (12th time in 13 months), ethylene oxide (second consecutive month; used in chemical synthesis, sterilization and fumigation), ethylene (ninth time in 10 months; used heavily in making ethylene oxide and plastic resins), methanol (sixth consecutive month; used heavily as a solvent and in synthesizing other chemicals), titanium dioxide (second consecutive month; a lead-free pigment used heavily as a whitener in coatings, paints, paper and other industrial applications), miscellaneous chemicals (eighth consecutive month) and semiconductors.

DOWN IN PRICE: Fuel oil (sixth consecutive month), natural gas (fourth consecutive month), cotton fabric and pepper.

IN SHORT SUPPLY: Aluminum (eighth consecutive month), copper (sixth consecutive month), nickel (third consecutive month), steel (14th time in 15 months), hot- and cold-rolled steel sheets (13th consecutive month), stainless steel (fifth consecutive month), castings, printing paper (third consecutive month), caustic soda (12th consecutive month), polyethylene, plastic resins, ethylene oxide (third consecutive month), ethylene (second consecutive month), ethylene derivatives (a fire at a major ethylene and ethylene-derivative plant is causing shortages), phenol (second consecutive month; used heavily in making phenolic resins), methanol (sixth consecutive month; caused primarily by a plant fire), methyl ethyl ketone (second consecutive month; used heavily as a chemical solvent in surface coatings and in making resins), methyl methacrylate (used in making hard clear plastics), titanium dioxide (10th consecutive month) and DRAMs, particularly 256K and 1-megabit dynamic electronic memory devices (third consecutive month; used heavily in computers), silicon (used in making integrated circuits, transistors, diodes and semiconductors) and latex disposable gloves.

The National Association of Purchasing Management's *Report on Business* records the actual changes and rates of change in six important categories of data: production, new orders, inventories, prices, vendor deliveries and employment. These six components, as reported, are not adjusted to compensate for seasonal variations.

Economists have devised a variety of formulas to compensate data for seasonal variations. N.A.P.M. cooperates with the U.S. Department of Commerce, which prepares the monthly Purchasing Managers' Composite Index for publication by N.A.P.M. The Department of Commerce adjusts the six components of *Report on Business* listed above, applies various weights to each and combines them into a single index number. The Composite Index is based on analysis by the Department of Commerce and is the only part of the report adjusted for seasonal variations.

Note: The next issue of *Report on Business* will be available July 5.

Commodity Reports

Energy

Prepared by the N.A.P.M. Energy Committee. Chair: Howard T. Perley, C.P.M., International Paper Company, Memphis, Tennessee.

Petroleum Products: OPEC and non-OPEC producers met in the last week of April, basically agreeing to meet again in June to consider reducing production by 2.5% to 5%. The fact that the meeting took place will hold crude oil in the $17.50-to-$18.50-per-barrel range. After the June meeting, if an agreement is reached, the price may range from $18.00 to $19.00 per barrel through 1988.

The producers believe that cutting production by 2.5% to 5% will increase the price to return the same net back. This is true as long as they are all following the agreement. If any one producer violates the agreement, prices will dip below $18.00 per barrel.

Residual fuel prices will trend with crude. However, watch Gulf Coast demand. If it is a hot summer, utilities may utilize either natural gas or residual fuel oil for their peaking turbines. (*Gary Chesnut, Ag Processing Inc., Omaha, Nebraska)*

Natural Gas: Most buyers of spot market gas were surprised by the sharp rise in prices last December caused by a combination of cold weather and changing federal regulations. Equally surprising was the rapid decline in prices this spring to last year's levels. Prices won't go much lower, so now may be a good time to lock in firm-priced spot gas purchase agreements for a 12-month period. Contracts starting in the fall could be better with prices firm only until next spring. The lowest-priced offer may not necessarily be the best purchase. Dependability of supply is just as important as price.

A buyer just beginning to purchase spot market gas should first contact the local gas utility. Find out where its other customers are buying their gas, and check out references for recommended gas marketers. However, not all local utilities have agreed to transport user-owned gas, and transportation is mandatory in only a few states. (*Ian G. Mackenzie, C.P.M., Corning Glass Works, Corning, New York*)

Electric Power: Utilities are continuing to face an increasingly difficult task in planning to meet future demand for electricity. All planning decisions are affected by major changes in the growth rate of consumption; changing production patterns from cogeneration and independent producers; and regulatory uncertainty regarding cogenerated power, wheeling and assessment of "prudence" in operations.

During the 1960s electricity sales grew at 7.3% per year. In the 1970s this rate decreased to 4.2%; during the past five years growth has been at 1.9%. However, growth should increase to a 2.4% rate over the next 10 years.

Cogeneration has become so popular that some utilities are faced with larger volumes of available power than are needed to meet current demand. Additionally, many are faced with the specter of lower-cost power becoming available to their customers if mandatory wheeling is implemented.

The real and potential pressures of increasing competition are bringing many utilities to more innovative and flexible approaches to supply major customers. For some customers, cheaper power is being made available from a more distant source. Rates are being reviewed to consider "unbundling" the components of service. Lower rates in exchange for an agreement from the customer not to install cogeneration is commonplace.

These concessions to major customers will dramatically reduce electricity costs for them. However, smaller users can also expect only slight increases in costs as the capital component of electricity is lowered due to reduced capacity additions. Over the next five years, electricity prices should increase at a rate less than that of overall inflation. (*George T. Gillespie, Abbott Laboratories, North Chicago, Illinois*)

Coal: During March, April and May, coal users worked off some of the inventories built before the February union negotiations. Shipments to users will then resume as Southern utilities prepare for high summer usage levels. Although some suppliers have been forced to pass through the advantages obtained in the UMW settlement, the coal market and prevailing prices should remain relatively unchanged through this printing. Railroad transportation costs are high and barge availability is tight. These elements of coal's delivered cost also will not change. (*Judith K. Perry, International Paper Company, Memphis, Tennessee*)

Steel

Prepared for the N.A.P.M. Steel Buyers Group by John E. Irvine, Del Monte Corporation.

The steel industry remains strong. For the past year, this column has emphasized the steel turnaround, the industry's return to profitability, increased prices, longer lead times and growing shortages, but always with a subtle hint of the possibility that it would not last, that demand would fall off and the steelmakers would try to maintain volume with another round of increased discounting.

This hasn't happened and by now is not likely to. Demand has remained strong. Orders are being booked well into the third quarter now, and the possibility of the fall-off that some were expecting in the second half of the year is more and more remote.

The N.A.P.M. Steel Survey for the month of April bears this out. For one thing, an ever-increasing number of respondents to the survey, from 39% in April of 1987 to 90% in April of 1988, reported current shortages or expected shortages within the next six months.

Demand remains strong despite inventory levels that have been building during the past few months. In the April survey, 87% of the steel-buyer respondents indicated they will maintain or decrease inventory levels during the next six months, while a growing number, from 12% in November 1987 to 35% in the April survey, consider their inventory levels to be too high in relation to demand.

The steel buyers in the April survey expect business to remain strong. All those surveyed (100%) expect their sales and production to remain level or to increase during the next six months, with 94% expecting their incoming orders to be the same or up during the next three months. For steel receipts 81% expect the next three months to be the same or greater.

The Voluntary Restraint Agreements and the weak dollar have brought steel imports down to a more tolerable level. A growing number of steel buyers in the April survey report less dependence on off-shore sources. Imports this year are expected to be around 17 million tons, down from a peak of more than 24 million tons in 1984.

So the domestic steel industry's bubble is not about to burst. Strong demand should continue at least through this year, the impact of imports should be minimal, and the steel companies have shown that they can manage their business effectively and profitably. The corner into better times appears to have been turned.